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Internal Revenue Service
memorandum

TL-N-7859-88

CC:TL:TS/MAKEYES

date: OCT 2 1988

to: District Counsel, Chicago [REDACTED]
Attn: [REDACTED]

from: Director, Tax Litigation Division CC:TL

subject: Effect of Partial and Complete Settlements under TEFRA
[REDACTED]

This memorandum is in response to review of your motion to dismiss for lack of jurisdiction and the later request for technical advice.

ISSUES

1. What is the effect on the TEFRA procedures of a specific matters closing agreement (Form 906) for non-TEFRA years, but which impacts on future TEFRA years?
2. Will a partial closing agreement for a taxable year remove all partnership items for that taxable year from the TEFRA proceeding?
3. Are these closing agreements partial or complete settlement agreements?

FACTS

[REDACTED] of [REDACTED] was issued an FPAA on [REDACTED], for the [REDACTED] taxable year disallowing interest expenses, depreciation, and other expenses. Two notice partners filed petitions within the time provided by section 6226(b). [REDACTED] and [REDACTED] filed a notice partner petition on [REDACTED]. The second petition was also filed on [REDACTED], by [REDACTED] and [REDACTED]. The two notice partner petitions allege that respondent erred by failing to recognize that respondent is required to allow the [REDACTED] and [REDACTED] a \$[REDACTED] distributive loss from the partnership for the [REDACTED] year based upon closing agreements entered into by the parties.

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Prior to the issuance of the FPAA for the [REDACTED] year, the [REDACTED] and [REDACTED] were issued statutory notices disallowing losses from [REDACTED] partnership for [REDACTED], [REDACTED], and [REDACTED] years. On [REDACTED], the [REDACTED] executed a Form 906 Closing Agreement in regards to claimed losses with respect to their partnership interest in [REDACTED] for [REDACTED], [REDACTED] and [REDACTED] years. On [REDACTED], the Service executed the closing agreement. The agreement specified the amount of losses allowable for [REDACTED]-[REDACTED] years, as well as a cap on losses which could be taken in future years in regards to [REDACTED]. The agreement also provided the amount of investment tax credit allowable for [REDACTED] and [REDACTED] years. The [REDACTED] entered into the same specific matters closing agreement on [REDACTED]. The Service executed the agreement on [REDACTED].

The cap on future year losses is determined by the taxpayers cash investment, reduced by the amount of allowable losses for [REDACTED], [REDACTED], and [REDACTED]. Based upon the closing agreement we are unable to tell if the [REDACTED] and [REDACTED] are entitled to a \$[REDACTED] distributive loss since the closing agreements do not specify the amount of petitioners' cash investment. Although the closing agreements state that a partnership interest was purchased for \$[REDACTED], there are no breakdowns as to the make-up of the \$[REDACTED] (i.e. cash or notes). The [REDACTED] does provide that an interest can be purchased for \$[REDACTED] cash or by \$[REDACTED] cash upon subscription, and the rest by [REDACTED] promissory notes due in [REDACTED] and [REDACTED].

Clearly, the only items on the FPAA for the [REDACTED] year involve loss items. There is no ITC adjustment, nor any type of adjustment which is not covered under the closing agreement.

CONCLUSION

The petitions filed by the [REDACTED] and [REDACTED], as notice partners, should be dismissed for lack of jurisdiction on the grounds their partnership items for the [REDACTED] year had been converted to nonpartnership items pursuant to section 6231(b)(1)(C). Since there were no other partnership items at issue in the FPAA, other than partnership losses for [REDACTED] year, petitioners had complete settlements for [REDACTED] and they were removed from the TEFRA procedures. Therefore, the [REDACTED] and [REDACTED] are no longer treated as parties to the partnership proceeding. See sections 6226(d)(1) and (2).

DISCUSSION

I. Effect of Partial or Complete Settlement

The first question to be addressed is the effect of a partial or complete settlement agreement upon the TEFRA proceedings. It is our position that a partial settlement agreement will not remove a partner from the TEFRA proceedings. Although a partner is bound by the closing agreement as to the partial settlement, these items will not be converted to nonpartnership items. 1/ Only when there is a complete settlement of partnership items for a taxable year will a partner be removed from the TEFRA proceedings. See section 6226(c) and (d).

Our position is based upon Temp. Treas. Reg. section 301.6224(c)-3T(b) which defines requirements for consistent settlements. The regulation states a settlement shall be "comprehensive", and a settlement may not be limited to selected items. This is the only place in the TEFRA provisions of the code and regulations where "settlement" is defined of any way. We interpret "comprehensive" to mean all partnership items must be settled before any partnership items will convert to nonpartnership items.

The TEFRA provisions provide for a bifurcated process for assessing partnership and nonpartnership items. See section 6229(a); section 6501(a); and section 6229(f). By distinguishing between partnership and nonpartnership items there are at least two statutory periods for assessment which must be tracked by respondent. Section 6229(f) provides a one year period for assessment of converted partnership items, which begins to run from the day the partnership items are converted to nonpartnership items. Settlement agreements will trigger the section 6229(f) period for assessment. We do not believe it was the intent of the legislature to further bifurcate the statute by allowing partial settlements to convert a partner's partnership items to nonpartnership items. Such a result could mean that there would be three or more statutes on assessment which would need to be tracked. By using "comprehensive" in the language of the regulations, it can be argued that a limitation was placed on

1/ We would caution that although this is a position we are asserting, it has not been litigated in the courts so we are uncertain as to its outcome. Therefore, it is advisable that assessments be made within one year of any settlements entered into regarding partnership items (whether partial or complete) until the issue is decided.

what constitutes settlement. Therefore, partial settlements will not trigger section 6231 (b)(1)(C). This limitation continues to provide for only two statutes on assessment, rather than further bifurcating the statute on converted items. 2/

II. Are These Closing Agreements Partial or Complete Settlements?

Next we must decide if these Form 906 closing agreements are partial or complete settlements. The closing agreements were executed by the [REDACTED] and [REDACTED] for non-TEFRA years, but impacted on future TEFRA years by setting a cap on allowable future partnership losses. That is the only issue which the closing agreements address for future years. The closing agreements do limit ITC, but not in future years. Therefore, since the FPAA only makes adjustments to partnership losses, petitioners [REDACTED] and [REDACTED] are removed from the TEFRA proceedings as they have no interest in the outcome of the proceedings. However, if the FPAA had disallowed ITC, then the [REDACTED] and [REDACTED] would have only executed a partial settlement agreement as the closing agreement did not limit ITC for future years. They would be bound to the closing agreement for treatment of the specific partnership items which the closing agreement referred to, but these items would not have converted to nonpartnership items. The [REDACTED] and [REDACTED] would still be parties to the proceeding as they would still have an interest in the outcome.

Since the [REDACTED] and [REDACTED] have a complete settlement for the [REDACTED] year, they are no longer parties to the TEFRA proceeding. The Form 906 settlement agreements were executed prior to the filing of the petitions pursuant to section 6226(b). Therefore, pursuant to section 6226(d)(2), neither the [REDACTED] or [REDACTED] can file a petition for redetermination of partnership items as they are not parties to the proceeding.

We agree that motions to dismiss should be filed for the notice partner petitions filed in [REDACTED] and [REDACTED]. In both cases the notice partners who filed were no longer parties to the action as they had no interest in the outcome of the proceeding since their partnership items had been converted to nonpartnership items pursuant to section 6231(b)(1)(C).

2/ Tax Litigation has recommended that the final regulations address the issue of partial and complete settlements and their effect on TEFRA. We are recommending that "comprehensive" settlement be addressed and incorporated into definition of settlement.

We disagree with your alternative argument that if the petitioners are limited to \$ [REDACTED] loss, they do not have a sufficient interest in the partnership proceeding. It is not the amount of loss which determines if a partner has a sufficient interest, rather the focus is whether a partner has an interest in the outcome. Nowhere in the TEFRA statutory framework or the regulations is there a requirement of a "sufficient interest."

After reviewing your draft of the motion to dismiss, we recommended a few changes. Everything from paragraph 15 on should be removed from the motion as it is unnecessary. There are also some dates and cites which need to be corrected. Attached is a copy of your draft with our revisions. A duplicate motion should be filed in [REDACTED].

Should you have any questions regarding this matter please contact Marsha Keyes, Tax Shelter Branch, at FTS 566-4174.

MARLENE GROSS

By: R. Alan Lockyear
R. ALAN LOCKYEAR
Senior Technician Reviewer

Attachment:
As stated.